DOW THEORY LETTERS INC.

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P.O. Box 15428
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36 Letters per Year — $60.00 Annually

Registered with the Securities Exchange Commission

April 11, 1969 Letter 424

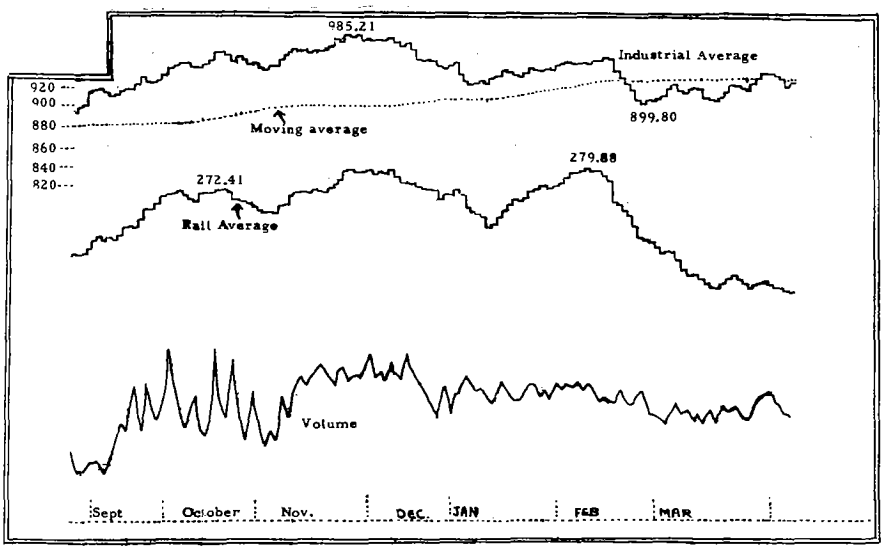
THE MARKET: In a local interview with Thomas Brekka, Treasurer of Rohr Aircraft, Mr. Brekka stated, "While prices may not go up as fast every year as we have seen in the last few years, we do have to expect the trend towards higher prices will continue in the future."

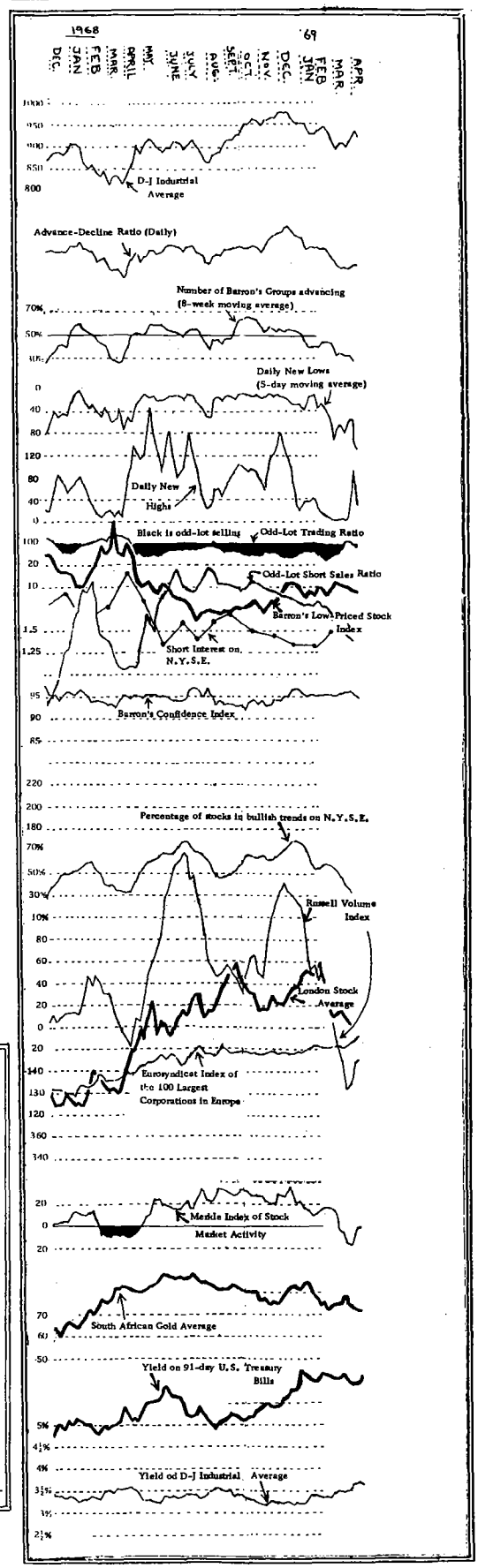
This, in a nutshell, is what everybody really believes and what everybody is planning on. Nobody can really fault Mr. Brekka for not being a cynic and not doubting a trend which has been in effect for almost a quarter of a century. Nobody can fault him for not thinking in terms of record interest rates and deflation within the framework of a primary bear market. The fact is that with a record 6% bank rate and a record 7.5% prime rate, inflation is still with us. It could take one or even two more boosts in the rate before inflation is stopped. By then, the die would be cast (as I believe it is even now).

The main fact about the Fed's action on the bank rate is that it was the Fed's way of saying that after years of whispering "Wolf," they have decided to get down to business. The Fed has decreed that the inflationary spiral will end, and just in case no one believes them, they have put the bank rate at the 1929 peak level.

As seen on this news clip (page 2) the high interest rates are having and will continue to have an increasing effect. Bonds are hard (in some cases impossible) to sell. Projects are being called off for lack of money. Plywood prices (a bellwether of the building trade) have suddenly slumped on the basic staple from $144 a few weeks ago to $110 today per 1000 square feet.

Meanwhile, the stockmarket, made up of the hopes, opinions, forecasts and dreams of everyone, is attempting to assess the situation. The Rail Average which is highly speculative has dropped to new 1969 lows. The Utility Average which is concerned with safety and yield (and which is competitive with bonds to some extent) has also sunk to new 1969 lows. The Industrial Average is more resistant to decline. Representing thirty of




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Meddle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield od D-J Industrial Average

the largest and best managed corporations in the nation, the Industrial Average is waiting for evidence, solid evidence, of the end of inflation. If money is available the Treasurers of these thirty Dow corporations have the skill, the power and the know-how to get it. The Industrial Average will not sag to 1969 lows as easily or as quickly as the speculative-oriented Rail Average or the yield-oriented Utility Average.

If the forces of counter-inflation and deflation are actually about to take hold, then it is most probable that we will see Industrials plunge below their 899.80 low for the year (set on February 25). If the forces of the primary bear market are going to slowly envelope the nation in first a recession, then a depression, we can be sure that sometime in the foreseeable future we will witness the Industrial Average embark on a plunge which will shake the financial structure of Wall Street, the nation and the world.

Admittedly, few see it that way. Few believe that inflation can be controlled (at least to some extent) while deflation cannot be controlled. But Dow's Theory teaches us that bull markets run to speculative excess and final madness. And Dow's Theory also teaches us that bear markets follow bull markets as surely as the night follows the day. The 1949-66 bull market has not yet been purged of its excesses. The thought of deflation following a 17-year bull market has never been taken seriously by Wall Street or the public.

Yet history is on the side of deflation. History says that the bear market which began on February 9, 1966, will ultimately express itself in deflation, collapse and depression. I see Dow's Theory as a mighty rudder to guide one in one's thinking, while the deceptive waves of business and finance serve mostly to confuse. Gold, high interest rates, warnings from Washington, the Vietnam war serve only as the vehicles which could set off the bearish forces this time around. If it had not been for them, there would have been other bearish items to take their place.

Bond Tieup Balks Funds For Schools

By JERRY RANKIN

SACRAMENTO (AP) — Construction of schools in communities with a big need for new classrooms may come to a sudden halt because of the soaring price of money, state officials said.

The interest rate now is substantially above the 5 per cent limit the state legally can pay.

The problem is so bad that in recent weeks the state had to cancel the sale of $100 million in bonds crucial to completing the water project, and received no bids for $40 million in bonds to finance new state buildings.

Patience, intelligence, and avoidence of greed will be the watchwords from here on. I do not know when deflation will actually start. I would guess that deflation in the stock market will start well before deflation in business. Watch the daily new lows as listed in your newspaper. Watch the Industrial Average and its ability to hold above 899.80. Watch public psychology as it attempts to grapple with changes which it does not and cannot believe. And play it safe, as outlined over and over again in these Letters.

INTEREST RATES: Last week the yield on the broad D-J 40-Bond Average rose to 7.07%, highest since the early 1930's. The yield on the widely-followed Moody's Aaa corporate bonds rose to an all-time record of 6.99%. The yield on the D-J Municipal Bond Index rose to 5.31%, highest since the early 1930's (at which time lower income taxes made tax-exempt municipals less attractive than they are today).

Over the past few weeks, for the first time, three U.S. Government bonds broke 70, the 3 1/2's of 1990 (now bid at 69), the 3's of 1995 (bid 68.18) and the 3 1/2's of 1998 (bid 68.20).

On March 25 a bombshell hit the bond market when it was announced that Transcontinental Gas Pipe Lines would come out with a 20-year debenture with an 8 3/8% coupon to yield 8.42%, the highest return of the century for a company's new issue of long-term debt securities.

With the prime rate at the banks at a record 7.5%, the interest charged on stock margin accounts varies from 8% to 10%. An interest rate charge of 8% to 10% is a very tough nut for the average investor or speculator. For instance, with the yield on the Dow Industrial Average at 3.5% and the average yield on all N.Y.S.E. stocks at around 3.05%, the high margin account cost means that if the market stands still, the margin operator stands to lose 5% to 7% a year on his money.

Since this is a primary bear market I do not believe that anyone can count on time being with the holder of stocks, and of course here I am referring to the intermediate and the long term (the short-term is anyone's guess). There is currently $5.9 billion in margins on the N.Y.S.E. This is going to be the next target of the bear market. This margin money is going to be squeezed out, time is against it, and margin money is not going to pay 8% to 10% for the privilege of holding stocks that on balance are moving sideways or down.

On top of this I am indebted to Mr. George Schaefer for coming with the information that last year only 18 of the 81 U.S. corporations with sales over $1 billion earned more than 8% on sales. With the cost of money to prime borrowers now at 7.5%, this means that a big corporation will think twice about expanding sales which bring in only around 8% profit.

Interest rates can move rapidly, but the effects of high interest rates show themselves more slowly. In the next six months we should see what a prime rate of 7.5% means to American business and to the American consumer. A straw in the wind may be that for the first third of March, auto sales dropped to their lowest comparable level in six years.

NOTES AND QUOTES: My subscribers are geographically distributed roughly according to the distribution of the U.S. population, which means that the great majority are not from New York. Even New Yorkers seldom get down to Wall Street so I thought this little description of "what's happening"on the Street would be of interest. It's from an article entitled "Are Wall Street's Happy Young Millionaires Being Paid Enough?" from the March 31 issue of New York Magazine.

When I read the article I was reminded of a different time, back in 1949 when I would sit in a New York brokerage office on a Saturday morning (that's right, the Exchange used to be opened Saturday) and watch the tape inch by (it would often be totally still for two or three minutes). In those days, five or ten people would be considered a normal crowd at my local Bache office, and volume would average 1 million per day. Times change, and change, and change.

The parking lots charge $5 a day ($3 for the first two hours), and in the covered garages the prices go as high as $6.75 for the man who wants to drive his car to Wall Street. Sales on the New York Stock Exchange run half a billion dollars on an ordinary day, and "the going price for margin clerks," a young broker says, "is $17,000 dollars bid." Oscar's Delmonico, where lunch runs about $7 a head, has had to break through to the next building to add tables, and even so a man without a reservation will not be able to get near a chair between 12:15 and 1:45. The DI4 and HA2 telephone exchanges are jammed beyond capacity, and at the brokerage houses the switchboards are forever breaking down.

On May 1 the first public offering of the so-called Midas Gold Fund will take place. The fund will presumably take positions and speculate in gold bullion. The fund will operate by creating share units, redeemable in bullion or monetary value. Gains realized through gold trading are to be distributed to unit-holders in the form of additional bullion.

Clifford Bennett, President of the new fund stated, "We expect to appeal to all income brackets, especially to wealthy people who want to own gold but find the details difficult. We'll keep our gold in a Zurich bank and the owners can go see it and count it." Asked about the response to the fund so far, Bennett said, "Amazing, we've been flooded." One minor factor, however. It is not at all clear whether it will be legal for U.S. citizens to own shares in the Midas Gold Fund.

GOLD: Under the current gold exchange standard, foreign central banks can hold dollars (which are convertible into gold) and pounds (also theoretically convertible) as reserves, exactly as if these two reserve currencies were gold itself. One of the weaknesses in the gold exchange system is that the U.S. has to run deficits in order for foreign central banks to build up dollar reserves.

In 1934 the price of gold was raised from $20.67 an ounce to $35 per ounce. At that time, the price of gold was considered "in line" with the general price level of other commodities. However, since 1934 the commodity price level has moved generally upwards, and over the past decade the forces of inflation have sent all prices through the roof. Only the official gold price of $35 per ounce remains on the 1934 bargain counter.

However, despite the U.S. Government's fixed price of $35 per ounce, the forces of the marketplace know that one of two things must happen, either the price of gold must ultimately get in line with other prices, or other prices must collapse and get in line with gold.

Historically, no government has ever purposely collapsed its economic structure in order to deflate back to a former gold value level. Historically, the price of gold has always (although sporadically) risen to put itself on a general level with other prices.

The U.S. Government, for political reasons, would rather "produce" more liquidity via the paper route than via the fundamental route. The fundamental way, of course, would be to raise the price of gold substantially, thus raising the real reserve base which is the gold itself.

A number of problems are now staring the U.S. in the face. One is that galloping inflation means that it takes more and more dollars to buy an ounce of gold on the free market. Since foreign central bankers are not idiots, they therefore increasingly prefer to hold bargain-priced gold as reserves, rather than dollars which are depreciating in value.

The U.S. is attempting to deal with this system by attempting to "slow down" inflation. The fundamental problem, which is that gold is far too cheap and getting cheaper every month, the U.S. is not willing to face. The danger in the

"dis-inflation" policy now being pursuedby the U.S. is that deflation has a habit of getting disorderly. When much of the business and commerce of the world is moving along on the working premise that "inflation is here to stay," the whole structure can come tumbling down if that premise suddenly turns out to be false.

In view of this, I was particularly interested to read in the latest Bolton Tremblay Bank Credit Analyst the following: "In the very unstable environment near the top end of the long term credit cycle, present Fed action, if pursued through April-May, could trigger a financial disaster. Odds definitely favor an easing of the squeeze before then."

The odds are in favor of easing the squeeze because the odds are always against a financial disaster and the odds are always in favor of the Government backing down if the forces of deflation become too powerful. The only question is, can the Fed turn the monetary faucets off and on fast enough to avoid damage?

I wonder in my own mind about which direction the U.S. is thinking. Are Nixon and his experts thinking in terms of curing the fundamentals or are they (like preceding Presidents) thinking in terms of dealing with symptoms? My only conclusion is that they are still thinking of producing more phoney liquidity rather than attacking the problem itself, the problem being the price of gold.

How can more liquidity be produced with $35 gold? Why, with paper gold or Special Drawing Rights (see clip from the Wall Street Journal, April 2). Yes, the U.S. is still hoping that the pathetic SDR's will somehow bail us all out of the gold predicament. Actually, only the U.S. and Britain favor the SDR's, and unless the problem of the eroding dollar value is confronted, who is going to want additional dollars in the form of SDR's?

Actually, if the U.S. is really still thinking in terms of paper gold, rather than a rise in the price of real gold (as this news clip suggests), then the situation is rather scary. It is scary because it seems clear that the market will finally have to settle the gold problem in its own way. If the nations do not get together and boost the gold price, then the forces of supply and demand will do it for them — with chaotic results.

That is why the price of gold is one of the most important economic barometers available today. At the current price of above—$43 per ounce for gold, the dollar is selling at a 23% discount in world markets. If the steady upward trend in the gold price continues, the dollar, at some point along the line, will collapse (i.e., it will be totally unwanted). This would mean a rush to turn in foreign-held dollars for gold. The U.S. would then have the unenviable choice of totally disconnecting gold from the dollar or embargoing gold. Either way, the dollar would become an unknown quantity, a piece of paper without known value.

No one will trade merchandise or currency with a known value for currency with an unknown value. The dollar would become a speculative piece of paper selling like a share on the exchange. So that's the story, the U.S. will have to deal with fundamentals or face the forces of the marketplace. So far, the marketplace is winning.

'Paper Gold' Will Get A Green Light in '69, Nixon Aide Predicts

He Says Losses of Reserves Are Making Europeans Amenable to Special Drawing Rights' Plan

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON — A green light for "paper gold" is confidently expected by year-end, a Nixon Administration official said.

Their own recent losses of present reserves of gold and dollars are making European authorities more amenable to the U.S. goal of early and sizable creation of paper gold, more formally known as "Special Drawing Rights," within the 111-country International Monetary Fund, the official indicated.

"I would certainly expect an activation decision this year," he said, adding that he has found "some willingness" among Europeans to agree with the U.S. view that more than a token amount of paper gold should be created. Neither the U.S. nor the Europeans have been mentioning specific figures, he said, but late in the Johnson Administration official opinion was that the amount should be several times greater than the $1 billion to $2 billion a year originally envisioned.

REALITY: Nobody really believed the Federal Reserve Board was serious. After all, they played footsie with inflation all during the Kennedy and Johnson years, and as the old adage runs, "the more things (Presidents, in this case) change, the more they stay the same."

I've been telling subscribers not to believe it. I've been telling them that Mr. Nixon sounded as if he was serious about stopping inflation. I've been telling subscribers, moreover, that Mr. Nixon hasn't much choice regarding ending inflation. But no one believed the writing on the Wall, as we note from these two newsclips from last week's papers. Factory orders

U.S. Factory Orders Jump for February

WASHINGTON (AP) — Manufacturers' orders took a strong upward jump in February, increasing twice as much as the monthly average of the preceding twelve months, the Department of Commerce reported Thursday.

BUILDING CONTRACTS reached a record $4.8 billion in February, up 30% from 1968, the F. W. Dodge division of McGraw-Hill said. Dodge's seasonally adjusted index rose 7% from January. All categories were termed strong, with nonresidential contracts up 51% from a year earlier and residential awards up 22%. But new interest-rate boosts and credit restraint probably mean the current pace of contracting can't be sustained for long, Dodge said.

keep climbing, building contracts keep climbing, auto inventories are the highest in history, consumers are still spending at a high rate.

Then on April 3 the news came out (just two weeks after Reserve Board Chairman said he hoped it would not be necessary to boost the discount rate). On April 3 the discount rate was raised to 6%, highest since 1929. On top of this (and here was the surprise), bank reserve requirements were raised, thus requiring an extra $650 million to sit idly in reserves. Immediately, bankers began talking about another boost in the prime rate, which is now a record 7.5%. If the U.S. had any doubts about tight money, those doubts were exploded on April 3.

The all-important Regulation Q was not altered by the Fed. Regulation Q states that the banks cannot pay more than 6.25% interest on Certificates of Deposit, and this means that investors are pulling their money out of the banks in favor of other higher-yielding instruments. Since December, the banks have lost $5.5 billion in C/D's. Part of this loss has been replaced by the banks through borrowing Eurodollars, but even this source is now running dry.

IS RECESSION A CURE NOW?

Efforts to curb the boom, so far, are a flop. Inflation is unchecked. An alarmed President Nixon is pushing to retain the surtax, make heavy cuts in the budget. But economists wonder: Will it take an actual recession to kill inflation?

Hopes Rise For Start Of Deflation

By THOMAS E. MULLANEY

A PUBLICATION of the Federal Reserve Bank of New York at the year-end cited the unexpectedly strong momentum built up by the nation's economy during 1968 and recalled Newton's second law of motion to illustrate why it was so difficult to bring the excessively accelerating force under control.

"The more massive the body," the bank noted, "the longer it takes to speed up or slow down."

Now, three months later, even after the application of massive restrictive forces in the monetary area to complement earlier fiscal reins, the economy is still barreling along under a full head of steam.

Some analysts have despaired over the problem, but most leading economists and Government officials are in agreement that the brakes that have been applied will soon show dramatic effect.

If an auto is running at 100 M.P.H. and it suddenly runs out of gas, I wouldn't bet on what would happen. It might survive the shock, or it might swerve and run off the road. If the greatest inflation-fed economic boom in history suddenly faces a money shortage plus the highest interest rates in history, what will happen? At what point does a boom collapse when the pin is stuck in the balloon? No one knows, but we do know that no boom in all history has survived a money and credit squeeze. In 1929 the bank discount rate was boosted to a final record 6% (as now), and two months later the market crashed. Will history repeat? The experts all tell us that this is different than 1929, that Washington knows more, that we have previous horrible examples to study now, and that the Administration knows how to handle things in 1969. Maybe so.

At any rate, I find it ironic that many are now actually hoping for deflation, as if deflation could be controlled and "handled" like a child's electric trains. Once the forces of deflation start (within the context of a primary bear market) the authorities may find that events will get out of hand, and that new stimulants prove useless. Keep these clippings for your scrap book (one is from the New York Times, one is from U.S. News and World Report). They may provide a bit of ironic humor a year or so from now.

A bull market topped out on February 9, 1966, and the primary bear market which followed was kept afloat by dreams, hopes, inflation, giant infusions of money, massive sales of gold, and mountains of pious words out of Washington. The primary bear market has been in force over three years now, but the teeth of the bear have never been exposed. Now the brakes have been applied to the boom in earnest. The 100 M.P.H. auto is running out of gas, and the brakes are being applied.

I don't know what to expect in coming weeks and months. But I wouldn't bet on the market or the economy ignoring the monetary situation much longer. I wouldn't bet on the bear market acting like "sleeping beauty" for the rest of 1969. And as I've said on numerous occasions, I hope my subscribers have all taken my warnings to heart.

CRISIS BAROMETER: French capital continues its flight out of the country, and the French franc continues to sag. The Bank of France is daily buying massive amounts of French bank notes in Switzerland in an effort to prop up the franc. On the week ending March 13, the Bank of France announced that the French reserves dropped $82.2 million. The following week France lost $42 million in reserves.

The Canadian prime rate at leading banks rose to 7.5%, in competing with the U.S. rate (which has since been boosted).

Leading Swiss banks are raising their interest on time deposits as the scramble for money sweeps Europe. Rates on Euro-dollars are now above 8.5%, as money-hungry American firms sop up all available funds.

The Deutsche Bundesbank raised its discount rate from 3.5% to 4%.

After dropping to $42.85, the price of hold has again pushed over the $43 level, and this despite the supposed successful passing of the "strike test" by the French franc.

Despite Federal Reserve anti-inflation measures, U.S. industrial prices during the first two months of 1969 had their sharpest rise in a decade.

The U.S. suffered an all-time record trade deficit for a single month, losing $361 million in February. The fantastic trade deficit was blamed on the dock strike.

STOCK TALK: Declines, even major declines, can be extremely deceptive. As an example, I have picked Ling-Temco-Vaught. Here we see a stock in a drastic state of collapse, having fallen from 170 to the low 50 area. Note on the daily chart that LTV in its action since July, 1968, has spent about half the time moving sideways or slightly higher. Those periods are enclosed in the three circles drawn on the chart.

Even more deceptive, from July to early November LTV formed a long, uptrending "line," then suddenly rallied from 88 to 111. Following this false rally, the stock caved in, the decline being stemmed only briefly by two periods of consolidation. However, it is interesting to put yourself in the position of a speculator studying the stock at each period of consolidation. During each of those periods one might well have been tempted to buy LTV because "it had come down from much higher prices, and because it appeared that the turn had arrived."

And that is exactly why it is so dangerous to buy stocks in a primary bear market or when they are in a bear market of their own. True bottoms are often accompanied by dragging, sideways action on very low volume, then a slow, deceptive, labored rise. We will see plenty of such action when this bear market runs its full course and bottoms out. (Chart of LTV courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62002).